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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER
May 27 2005 ISSUE

¶1. Summary. Each week, AmEmbassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:
- Inflation Increases Just Under Market Expectations;
- Provinces Failed to Spend Capital Budgets;
- Provincial Capacity for Health and Education Capital Spending Problematic;
- South Africa's Poor Do Save;
- South Africa Plans to Insure Bank Deposits; and
- Housing Market Cools Down.
End Summary.

Inflation Increases Just Under Market Expectations

¶2. April's Consumer Price Index (CPI) increased 3.4 percent (y/y) and CPIX (CPI excluding mortgage costs) by 3.8 percent (y/y), just under market expectations of 3.5 and 3.9 percent, respectively. The main reasons for April's increase are housing, transport, medical care and health expenses, and education. In April, gasoline prices increased 40 rand cents/liter, contributing most to the increase in transport costs. This increase in transport costs is not expected to be as large in May, as gasoline prices only increased by 20 cents/liter. June's gasoline prices are expected to decline, signaling reduced inflationary pressure from fuel costs. Recent rand weakness suggests that reductions in interest rates in June are unlikely, although CPIX inflation is expected to remain well within the 3 to 6 percent targeted range. The South Africa Reserve Bank (SARB) expects CPIX inflation to range between 4.5 and 5 percent from 2005 through 2007, well within the inflation target. (Standard Bank, CPI Alert and Investec, CPIX Update, May 25; SARB Monetary Policy Review, May 2005)

Provinces Failed to Spend Capital Budgets

¶3. Provincial governments failed to spend nearly R2 billion ($308 million at R6.5 per dollar) of their R12 billion ($1.8 billion) total capital budget in the 2004/05 fiscal year. The detailed provincial budgets, released by the National Treasury, raise concerns about government's ability to increase investment spending in key areas. More than 60 percent of the national budget is spent through provinces and municipalities, with all nine provincial governments directing nearly 99 percent of their budgets to core social services functions of education, health, and welfare. The Treasury said provinces had controlled their budgets better in 2004/05, with only four of the 117 provincial departments overspending significantly, compared with 12 in 2003/04. However, 26 provincial departments significantly under spent their budgets, with Treasury expressing concern that capital spending was the largest category with unspent funds. Mpumalanga spent only two-thirds of its capital budget, while North West, Northern Cape and Free State spent three-quarters or less, and Gauteng spent only 85 percent of its capital budget. Capital budgets in the provinces cover items such as the hospital revitalization programs and the building of new clinics, schools and classrooms, as well as infrastructure such as roads and tourism facilities. (Business Day, May 20)

Provincial Capacity for Health and Education Capital Spending Problematic

¶4. Provincial capacity to spend future capital budgets appears to be falling short, with education and health spending particularly problematic. Government has budgeted for more than R40 billion ($6 billion) in capital spending by the provinces over the next three years. Provincial capital spending on education in 2004/05 amounted was nearly R30 million ($5 million) lower than in the previous year. In health, the absolute decline in capital spending was even worse, with provinces spending R438 million ($67 million) less than 2003/04. Mpumalanga and Northern Cape's health

capital spending were the lowest while KwaZulu-Natal spent the most of their allocated health capital budget. Provincial spending on social grants showed signs of stabilizing, with only KwaZulu-Natal, Eastern Cape, and Gauteng overspending their adjusted social grants budgets. Overall provincial spending on the core education, health and welfare services rose 11.6 percent to R155.5 billion ($24 billion) in the 2004/05 fiscal year, with social development (mainly grants including pensions, disability and child support) increasing by 20.6 percent to R50.7 billion ($7.8 billion), or 26.9 percent of total provincial expenditure. Comprehensive education spending in the nine provinces rose only 8.2 percent, to R64.4 billion ($9.9 billion), while total health spending increased by 7 percent. (Business Day, May 20)

South Africa's Poor Do Save

¶5. New research examining the expenditure patterns of poor households suggests that despite high unemployment, South Africa's poor realize the importance of saving for funerals, education and emergencies and they try to save. The goal of the research project called Financial Diaries was to present a comprehensive picture of the financial inflows and outflows of poor households by gathering data on income, consumption, savings, lending, and investment. The research was conducted by the Southern African Labor and Development Unit at the University of Cape Town and sponsored by the Ford Foundation, FinMark Trust, and the Micro Finance Regulatory Council. Interviews were conducted every two weeks for a year from 166 black households in Langa in Cape Town, Diepsloot in Johannesburg and Lugangeni, a rural village in Eastern Cape. On average, households used 17 different financial instruments over the course of a year, four savings instruments, two insurance instruments, and 11 credit instruments. Only 38 percent of the poor households surveyed used formal, long-term savings instruments such as retirement annuities, while 67 percent belonged to at least one stokvel (an informal savings group where each member contributes a monthly amount and then can withdraw once a year) and burial society (an insurance program to fund funerals). One of the problems with informal instruments, such as burial societies, is that they are not guaranteed or protected. According to the respondents in the study, stokvels are intended as savings for a specific item, event, or for emergencies. More than 80 percent of the respondents hide money away somewhere in their homes, so that it is easily accessible during emergencies. Keeping money at home is seen as more cost-effective, as traveling to a bank and using ATMs costs more for township and rural dwellers. However, this form of saving is less effective as they are more likely to lend it out to neighbors and family relatives, or use it. The study found that although 67 percent of the households surveyed had a savings account, it was mainly used for transactions rather than a means for long-term accumulation. Ninety-five percent of households pay off some form of debt every month. About 24 percent are considered to be highly indebted, with average monthly debt payments of 31 percent of monthly income. "Highly indebted" is defined as having average monthly debt payments of more than 20 percent of total income. The study found that highly indebted urban households made 80 percent of their payments to formal financial credit institutions, while their rural counterparts paid 71 percent to informal creditors. (Business Day, May 24)

¶6. Comment. As of May 15, 2005, Mzansi low-cost bank accounts, aimed at the poor and introduced in October 2004, numbered one million. Over 91% of Mzansi account holders have not previously held an account with their current institution. An average of R325 ($50) is held in each account. The current breakdown of Mzansi accounts among the five financial institutions is as follows: Post Bank 28.2 percent, ABSA Bank 26.9 percent, Standard Bank 22.4 percent, First National Bank 15.5 percent, and Nedbank 7 percent. End Comment.

South Africa Plans to Insure Bank Deposits

¶7. Deputy Finance Minister Jabu Moleketi announced plans to introduce deposit insurance to South Africa. Moleketi said his department was addressing "regulatory barriers to the entry of new players, products and services in the market." These included the introduction of the Co-operative Banks and the Dedicated Banks Bills, as well as a rewrite of the Pensions Fund Act and the introduction of the South African deposit insurance plan. The two bills are designed to increase competition in the banking sector by providing a framework for new entrants such as community-based banks. The bills are scheduled for parliamentary hearings in October. The deposit insurance plan, considered for the past three years and intended to avert failures such as those of Saambou Bank and Regal Treasury Bank, could result

in higher bank charges. The level of deposits that would be covered has not yet been finalized, but all depositors would be covered up to a certain amount. Jonathan Dixon, Chief Director of Financial Regulation at the National Treasury, used a study on competition in the banking sector prepared in 2004 for the National Treasury and the Reserve Bank to craft new regulations for the financial sector. The study found that disclosure of the cost of banking services was weak, the control of the essential infrastructure of the payments system was in the hands of the four large banks, and that low and middle-income earners faced exceptionally high bank charges. (Business Day and Business Report, May 25)

¶8. Comment. USAID and U.S. Treasury funded technical assistance for both the banking competition study and deposit insurance plan. End Comment.

Housing Market Cools Down

¶9. South African housing experts say that the residential property marketing is cooling down. The total real value of building plans passed for residential buildings was down 3.7 percent in the first quarter of this year, compared with the fourth quarter of last year, confirming analysts' perceptions about the slowdown in the market. Absa Bank senior economist Jacques du Toit said that according to the latest building statistics, released by Statistics SA on May 18, the total real value of plans passed in the first three months of this year was R4.9 billion ($750 million), compared with about R5 billion ($770 million) in the last quarter of last year. But he said that year-on-year, the total real value of residential building plans passed increased slightly, 3.5 percent, compared with the same period last year. However, Du Toit said that this increase was small in comparison to the 39.6 percent increase in 2004 over 2003. Du Toit said house-price growth was on a downward trend and this could probably be ascribed to the fact that housing had become less affordable, taking into account the high level of house prices, salary and wage increases well below 10%, and mildly lower interest rates. First National Bank chief economist Cees Bruggemans indicated that the boom in the market was not sustainable and that the market cool down was not surprising given interest rate cuts in 2003 and increased demand in residential buying and building activity last year. (Business Day, May 26)

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